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February 22, 2011

Jennifer J. Johnson, Secretary
Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue, NW
Washington, DC 20551

Via email: regs.comments@federalreserve.gov

RE: Docket No. R-104 and RN 7100 AD63
Proposed Rulemaking on Debit Interchange Fees and Routing

Dear Ms. Johnson:

The Bankers Bank ("TBB") provides a wide range of operational products and services to hundreds of community banks located in Oklahoma, Texas, Arkansas, Louisiana, and elsewhere. Our holding company, Bankers Bancorp of Oklahoma, Inc., has nearly 100 shareholders, all of which are community banks or their respective holding companies. As President of both organizations and on behalf of their shareholders, I respectfully register our profound misgivings over the recently-proposed rule by Board of Governors of the Federal Reserve System ("the Board") pertaining to Debit Interchange Fees and Routing ("the Proposal"). For the reasons stated below, the Proposal as currently framed will produce unintended, but nonetheless foreseeable insalubrious consequences to community banks, their customers, and the economy.

I. Market Forces Will Negate the Affect of the Small Issuer Exemption.

Most of our respondent and shareholder banks are family-owned or closely-held; and all of them have assets of less than \$10 billion. For them, debit cards are hardly a profit center. Rather, community banks offer debit cards as a convenience to our consumer customers, and local merchant customers, so they are not at a competitive disadvantage with mega-banks.

Though Congress and the Board purport to shelter smaller issuers such as TBB's respondent community banks from impact by the Proposal's interchange cap, the effort will not achieve its purpose. Just as mega-merchants used their market clout to convert U.S. manufacturing into a foreign "race to the bottom," they will use the proposed interchange rate cap to drive down community banks'

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debit card pricing to the limit imposed on financial institutions with more than \$10 billion in assets. Since the Proposal lacks any mechanism to assure the protection of small issuers, the exemption is mere window-dressing.

Industry estimates project that, without a meaningful exemption from the rate cap, small issuers' revenue from debit cards will be reduced by approximately 75%. It must be emphasized that we do not complain because the *de facto* rate cap would cut into community banks' debit card profits. Rather, since community banks typically do not have sufficient transactional volume to get the price breaks designed for their super-sized fellows,¹ the reduced revenue will cause many if not most community banks' debit card businesses to operate at a loss.

II. The Proposal Adversely Impacts the Development of Antifraud Technology.

Today, much of the revenue in excess of debit card operating expense is reinvested in fraud detection. This technology is hugely expensive. In his State of the Union address earlier this month, the President repeatedly exhorted all segments of our society to "win the future," to "out-think and out-innovate" our global competitors. Yet the Proposal reduces or eliminates their technology investment funding source, thus forcing issuers of all size to find their antifraud solutions on the double-cheap. Most cybercrime of late originates from Eastern Europe, the Middle East and Asia. So, if exo-sourcing weren't already bad enough for the economy in general, the Board seems determined that banks look to the same countries for answers to a problem that caused part of the problem in the first place.

III. Regulation Cannot Timely and Adequately Recognize the Extent of Fraud Risk.

It is impossible to fully evaluate the Proposal because the Board has not yet proffered a specific fraud adjustment. However, TBB submits that no regulatory scheme can timely and adequately quantify debit card systemic fraud risk, because the Board necessarily works with aged, trailing data.

¹ Some reports have surfaced that VISA is considering implementation of a dual interchange system for large and small financial institutions. However, VISA itself notes that changing to two separate interchange structures will present substantial difficulties, as it will require the consent of all stakeholders in the system, from the point-of-sale back to the issuer. Moreover, large retailers would still be able to route their transactions to minimize their cost, at the expense of community banks and consumers. Thus, it seems clear that VISA's plan will not save small issuers and their customers from the negative impact of debit card interchange rate fixing.

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In this challenging economic environment, most community banks in the U.S. are experiencing unusually high fraud losses. If allowed to do so, issuers will continue to manage the changing risk landscape as they currently do: by charging merchants a competitive, market-commensurate interchange fee.

This is only fair, as merchants receive the immediate, guaranteed benefit of fraudulent debit card transaction, and have no responsibility for the losses associated with that fraud. Consequently, there is little incentive for any merchant to adopt any debit card fraud protection measures, or even cooperate with the issuer's loss recovery efforts. Furthermore, some of our respondents have reported incidents in which a certain "big box retailer" who shall remain nameless actually refused to return any calls or otherwise assist their fraud investigations.

Certainly, this merchant is entitled to serve its own financial interest, and we recognize that it will not earn or save itself any money by cooperating in debit card fraud investigations. What we find unconscionable is this particular merchant's use of its record-breaking profits to lobby for rules which force community banks, without reasonable compensation, to bear all the risk of fraud for that merchant's misgotten gains.

IV. ATM Transactions Are Not Properly Subject to This Debit Card Interchange Fee Regulation.

Its enabling Durbin Amendment legislation does not authorize the Board to regulate fees for the use of ATM devices. While a single plastic may be equipped to execute the consumer's desired business with her financial institution (ATM), and with her merchant (debit card), each type of transaction operates on a separate system. The Board seems to acknowledge this distinction in light of the existing structure of ATM transactions. We respectfully suggest that the Board not muddy these waters, by simply stating that the Proposal has no application to any ATM functionality.

V. The Proposal Will Adversely Affect Consumers, Small Merchants, and Community Banks.

Contrary to the Board's express intent, the present Proposal will only hurt consumers, especially those who are customers of community banks.

When faced with operating their debit cards at a loss, some community banks will choose to

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discontinue that service offering. The rest will implement pricing strategies (i.e., higher fees tied to debit card usage, general account maintenance, etc.) designed to shift some or all of that loss to their customers, comprised of both consumers and small merchants.

In turn, when faced with their share of the increased cost, both sets of customers will pressure their community banks to match the interchange fee cap applicable to the big banks. Since, as discussed in Section I, community banks don't have sufficient cushion in their debit card products to comply, some local merchants will opt against accepting payment via debit cards. However, that option would disadvantage local merchants vis-à-vis their mega-store competitors, which does accept (and, indeed, for its cheap, risk-free, immediate funding, quite rightly prefer) that convenient form of payment. Thus, it is the community banks' customers who lose, by paying higher fees, by having fewer product choices, and by facing greater confusion regarding debit card acceptance. Therefore, most consumer and local merchant customers would likely move their banking relationships out of their community banks, and further enlarge the handful of banks that are already too big to fail.

The only real winners under this Proposal are the consumer retail giants, typified by that uncooperative superstore referenced in Section III. Of course, such a merchant does its banking with a huge financial institution, for which the interchange fee cap (though unfairly skimpy) will not make or break the feasibility of its lower cost/greater throughput debit card product. Given the disproportionately adverse consequences of the Proposal on consumers, small merchants and community banks, is it truly reasonable to believe that mega-merchants will pass "cost savings" along in an amount that is meaningful to consumers? TBB respectfully submits that it is not.

Conclusion

We fully understand the current social pressure on government instrumentalities to be perceived as taking affirmative steps on behalf of consumers, and against "the greedy banks." Likewise, we know the general public attributes the same bad odor to all banks. Because of this conflation, from time to time we must point out that community banks account for only a negligible portion of the bail-out debacle, and that it is not our wholesale omission to observe formalities that attorneys general in 50 states are calling mortgage fraud. Community banks earn their income the old-fashioned way: by taking deposits, paying debits, making traditional loans, and providing bank-related services. Ours is a measured risk – low margin business.

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On occasion, we have found that the Board's regulatory approach also omits its customary mature consideration of the differences, in operational realities and customer bases, between community banks and behemoth financial services conglomerates. This is one such occasion. Accordingly, we strongly urge the Board to revisit the Proposal in light of its probable impact on the nation's community banks. Further, we respectfully request an extension of the contemplated implementation date, to permit Congress an adequate opportunity to digest the negative implications of its legislation brought to light by the myriad comments filed in response to the Proposal.

Thank you for your attention.

Sincerely,

Don Abernathy, Jr.

Don Abernathy, Jr.
President